

STATE OF COLORADO

BOARD OF LAND COMMISSIONERS

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DEPARTMENT OF
NATURAL
RESOURCES

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February 2, 1996

Minerals Management Service
Royalty Management Program
Rules and Procedures Staff
P.O. Box 25165, MS 3101
Denver, CO 80225-0165

RE: "Amendments to Gas Valuation Regulations for Federal Leases"
published in the Federal Register November 6, 1995, at 60 F.R.
56007

Dear Sir or Madam:

The Colorado State Board of Land Commissioners ("The Board") thanks the MMS for giving us the opportunity to provide comments to the above cited proposed rule. The Board recognizes that given the new environment since FERC 636, application of the existing gas valuation regulations became more difficult. The Board offers the following comments in response to the proposed rule.

1. Alternative Valuation Standards for Unprocessed Gas and Processed Gas

A. Additional Royalty Payments for Index Payors

The Board is strongly opposed to index-based methodology without assurance that index prices remain at or above market value. We believe that a comparison to gross proceeds is necessary as long as index-based pricing applies. Index cannot be relied upon as a full indicator of market value because it represents only spot market sales, and excludes long term contracts. The Board believes that approximately 50% of gas produced today is sold on the spot market. The safety net assures that index payors will pay royalties that more closely resemble market value. It provides the only assurance that index-based values will not result in lower royalty revenues than those received under gross proceeds.

The Board strongly recommends eliminating any limitation on the additional royalty adjustment that an index payor may have to pay and feels that royalty payors should pay on market value or median gross proceeds. If the median gross proceeds value is higher than index value, index payors must pay on the higher value. By placing limitations on the additional

royalty amounts that index payors must pay, the MMS has moved away from the long-standing regulatory requirement that royalty value should be no less than gross proceeds. If index payors are allowed to pay on less than market value, gross proceeds payors are clearly being treated inequitably. The median value approach already provides protection to the index payors by eliminating the higher priced contracts, therefore, there should be no cap.

The Board also recommends that great care and analysis be taken when determining the zones that qualify for index pricing. Areas must not be defined too broadly so that one zone would include production that serves totally different markets.

B. Numerous Elections Available to Index Payors

The number of elections available to an index payor is excessive and cumbersome. The Board is opposed to options that allow the payor to manipulate the royalty value. Under any particular election, a payor would most logically elect whichever method minimizes the royalty burden. This undermines the market value approach on which royalties have historically been valued.

In order to dissuade royalty manipulation, the two-year index election period must be retained, recognizing that there may be a positive effect for the payor in one month and a negative effect in the next month. By retaining the two-year period, hopefully the positive and negative effects would even out. One of the Committee's primary goals, as stated in the preamble, was to provide simplicity in valuation of gas produced from Federal leases. The Board believes that by allowing the payor numerous options, these goals were not accomplished. Fewer options should be made available to payors because the proposed rule discriminates against gross proceeds payors.

2. Transportation v. Gathering

The preamble did not state whether the revenue impact on the proposed definitions of gathering and transportation was examined. The Board believes it would have a negative impact on royalty. We recommend that these definitions not be fully implemented in the final rule and the issues be reexamined. The proposed definition of transportation incorporates some gathering costs that will have a major negative revenue impact.

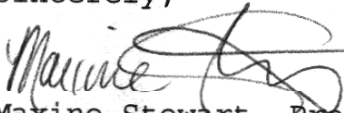
3. Topics on which MMS Requested Comments

The MMS requested comments on contract settlement payments entered into prior to the effective date of a final rule with the payment coming either before or after the effective date of the final rule. The Board recommends that the MMS apply the existing policies for contract settlements to both gross proceeds and index payors. Requiring gross proceeds payors to pay on contract settlements while not requiring the same on index payors demonstrates another area of inequitable treatment.

The MMS requested comments on improvements to the existing benchmarks for valuing gas sold under non-arm's-length contracts in areas without active spot markets. For those non-arm's-length sales from leases that fall outside of a qualified zone, an alternative valuation method must be determined. The Board recommends that the MMS retain great latitude in determining value for such sales and retain the ability to pursue the highest possible price.

The Board appreciates being given the opportunity to participate in this process.

Sincerely,



Maxine Stewart, President
Colorado State Board of Land Commissioners

c: Vicki Bunch - Colorado DOR Mineral Audit Section